Is This Cash Cow Running Dry?

Description

One of the companies I've had on my watch list but haven't been watching that closely of late is **Saputo** (TSX:SAP). This Canadian dairy company has been in the news lately. Unfortunately, most of this news has been around challenges the company faces.

Since mid-May, Saputo has lost nearly 30% of its value in quite the rout. Much of this has to do with fixed-cost absorption and operational efficiencies.

Is Saputo turning the corner? Or is this a cash cow to avoid?

Let's dive in.

Saputo expected to be range-bound amid industry challenges

Desjardins Securities analyst Chris Li is of the view that Saputo is making the best of a difficult situation. After the Investor Day event, his expectations appear to be muted. He anticipates that this Montreal-based dairy product producer's shares will stay range-bound amid industry challenges for the upcoming few months.

That said, Mr. Li reaffirmed a positive longer-term view. This view is based on the impressive long-term earnings growth potential of SAP. As the dairy markets normalize, it's expected that value-accretive acquisitions and organic growth will improve.

Mr. Li turned out to be one of the few analysts on Wall Street to reduce their target price and financial estimates for SAP shares. This is based on SAP's short-term challenges.

He is now anticipating FY22 EBITDA to reduce by 4% year-over-year compared to an earlier 2% increase. This is a result of Saputo's own comments that EBITDA growth in FY22 would be highly challenging.

They are further expecting meaningful improvement in EBITDA growth in FY23. Price increases, foodservice recovery, improving market factors, easy comps, and the early benefits of the global strategic plan are the major drivers for this positive longer-term view.

Saputo appears to be confident in its organic EBITDA target of $2.125 billion in FY25. Mr. Li states that their revised FY25 EBITDA estimate is 8% lower than the management's target, thereby accounting for uncontrollable factors.

Applying a long-term average multiple of 12.5 times forward EV/EBITDA to their FY25 EBITDA forecast would impute a $53 equity value for a share in 2.5 years. This indicates an impressive 21% average annual return. There is additional upside from M&A along with FCF and a solid balance sheet of SAP.

Bottom line

Saputo remains a buy in Mr. Li's mind and in my mind as well. This is a long-term company, providing a meaningful dividend currently yielding 2.4%. I continue to view Saputo as I would a high-grade bond — a stock to add for defensiveness and a bit of income over time.

I think this stock has the potential to grow nicely over the long term. While short-term issues may slow this process, Saputo is still a company I think investors should put on their radars right now.

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Date
2025/07/23
Date Created
2021/10/29
Author
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